



Jemena Electricity Networks (Vic) Limited

AMI Initial Charges Application for 2012 - 2015

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1 Executive summary

1.1 Summary of proposed charges

Simultaneously with this document, Jemena Electricity Networks (Vic) Ltd (**JEN**) has submitted a subsequent budget period budget application (**subsequent budget application**) to the Australian Energy Regulator (**AER**) that details JEN's costs associated with the provision of Regulated Services over the 2012-2015 budget period (**subsequent budget period**).

The roll out of advanced metering infrastructure (**AMI**) is a huge undertaking, possibly the single most significant enhancement to electricity distribution infrastructure in the state's history¹.

This charges application details JEN's proposed charges for 2012 to 2015 and costs associated with Regulated Services, as allowed under the AMI Cost Recovery Order in Council (**AMI Cost Recovery Order**)².

The charges proposed in this application are consistent with the AMI Cost Recovery Order, and with pricing principles established by the AER in its Framework and Approach Paper³ (**the AER Approach Paper**). The JEN's proposed charges are simple and comprehensible, with a price path designed to manage customer impacts effectively.

A summary of the charges proposed is as follows.

Table 1.1: Summary of proposed charges

Nominal \$/meter	2012	2013	2014	2015
Single phase single element	149.00	152.84	155.22	157.64
Single phase single element meter with contactor	149.00	152.84	155.22	157.64
Three phase direct connected meter	183.11	187.82	190.75	193.73

¹ Media Release by Energy and Resources Minister Peter Batchelor, *Smart Electricity Meter Roll-out Set to Start for One Million Electricity Customers*, 3 April 2009

² Order Under Section 15A and Section 46D of the Electricity Industry Act 2000 made on 28 August 2007, as amended by the Order in Council made on 12 November 2007, the Order in Council made on 25 November 2008, the Order in Council made on 31 March 2009 and the Order in Council made 19 October 2010

³ AER Framework and approach paper – Advanced metering infrastructure review 2009-11, Final Decisions, January 2009

Nominal \$/meter	2012	2013	2014	2015
Three phase current transformer connected meter	203.58	208.82	212.08	215.39

The increase in charges in 2012 from the current level reflects the significant investment required by JEN to continue to implement the mandated AMI obligations. JEN's proposed charges smooth the impact of price changes on customers and deliver real price decreases following the end of the mass roll out in 2014 and 2015. Consistent with provisions in the AMI Cost Recovery Order, JEN has chosen to spread out the recovery of the costs of the roll out beyond 2015.

1.2 Structure of this report

This report is structured as follows:

Chapter	Title	Details
2	Regulatory requirements	Outlines the regulatory obligations requiring this charges application to be submitted to the AER by 28 February 2011. It also describes the information JEN relied on in preparing this charges application
3	Weighted Average Cost of Capital (WACC)	Sets out JEN's proposed WACC parameters for the subsequent budget period, including placeholder values for market observable parameters that must be determined in 2013.
4	Taxation	Provides JEN's calculation of taxation losses to be incurred in the subsequent budget period and sets out JEN's proposal on the value of imputation credits to be used in 2014 and 2015.
5	Proposed charges	Sets out JEN's proposed charges, with an explanation of how the charges comply with the AMI Cost Recovery Order and the AER's pricing principles.
Appendices		
A	AER templates	
B	2009 Regulatory Accounting Statements	

2 Regulatory requirements

2.1 Overview of regulatory obligations

Under clause 5A.1(c) of the AMI Cost Recovery Order, by 28 February 2011, JEN must submit a charges application proposing initial charges for each of the years commencing 1 January 2012, 2013, 2014 and 2015 (**2012-15 initial charges**).

The form and content of this initial charges application is determined by the AMI Cost Recovery Order, guidance provided in the AER Approach Paper, and the information templates provided by the AER. In particular, this application complies with the general application requirements in clauses 5 and 5A of the AMI Cost Recovery Order.

The AER's determination is to be made in accordance with the regulatory principles in clause 4.1 of the AMI Cost Recovery Order, the general application requirements in clause 5 and 5A, and the process set out in clause 5E.

2.2 Information relied on

This charges application describes the proposed 2012-2015 initial charges, based on:

- the actual costs and revenues over 2009, as submitted in JEN's regulatory accounting statements (regulatory accounts) for that year
- JEN's current best estimate of the actual costs and revenues over 2010 that will be submitted in JEN's regulatory accounts by 30 April 2011
- JEN's current best estimate of costs and revenues for 2011, and
- forecast costs for 2012-2015 set out in JEN's subsequent budget application submitted to the AER with this charges application.

2.2.1 Regulatory Accounts

This application relies on JEN's regulatory accounts for the calendar year ending 31 December 2009, as submitted to the AER on 30 April 2010, and provided with this application as Appendix B.

2.2.2 Estimate of 2010 costs and revenues

This application relies on JEN's current best estimate of costs and revenues over 2010, as set out in the charges templates submitted with this charges application as Appendix A.

These figures are based on JEN's current work in preparing regulatory accounts for the calendar year ending 31 December 2010. These accounts will be finalised and submitted to the AER by 30 April 2011. The 2010 figures provided in this application are estimates only and remain subject to internal review and external audit. The final figures to be used by the AER for the purposes of its final determination are the figures that will be reported in JEN's final 2010 regulatory accounts. Once those accounts are finalised and submitted to the AER, JEN will provide the AER with a revised filled out version of the AER's charges templates, to update for the final actual 2010 figures.

2.2.3 Estimate of 2011 costs and revenues

This application relies on JEN's current best estimate of costs and revenues over 2011, as set out in the charges templates submitted with this application as Appendix A. JEN's charges revision application, to be submitted 31 August 2012, will provide actual costs and revenues for 2011.

2.2.4 Subsequent Budget Application

In accordance with clause 5.3 of the AMI Cost Recovery Order, this application relies on information submitted to the AER in JEN's subsequent budget application, submitted to the AER at the same time as this charges application. Relevant section references are provided within the text of this application.

Importantly, this application relies on details of the contract expenditure incurred, as described in the subsequent budget application. Clause 5E.3(a) of the AMI Cost Recovery Order requires that in determining the 2012 to 2015 building blocks costs, the operating expenditure and capital expenditure must be derived from the Approved Budget. The Approved Budget will include, if relevant, the AER's determination of any revision to JEN's subsequent budget application.

The forecast capital and operating expenditure over the subsequent budget period is set out in JEN's subsequent budget application and summarised in Table 2.1 below.

Table 2.1: Forecast capital and operating expenditure over subsequent budget period

Real 2011\$m	2012	2013	2014	2015
Total forecast capital expenditure	34.1	17.9	7.7	7.3
Total forecast operating expenditure	19.4	17.2	15.8	15.9
Forecast Total Opex and Capex	53.5	35.1	23.5	23.3

Note: Figures in tables may not add due to rounding

3 Weighted Average Cost of Capital

In determining the return on investment building block, clause 4.1(d) of the AMI Cost Recovery Order specifies that the Weighted Average Cost of Capital (**WACC**) must be used in calculating the return on capital. Clause 4.1(i) specifies how the AER must calculate the WACC input parameters to be used over the initial AMI WACC period (2009-2013), which spans the initial AMI budget period and the first two years of the subsequent budget period. The AER set those parameters in its determination on JEN's initial charges application. The WACC parameters and values to be used for 2012 and 2013 are shown in Table 3.1.

Table 3.1: WACC parameters and values to be used for 2012-13

WACC parameter	Value
Risk free rate	4.63%
Debt risk premium (inclusive of debt raising costs)	4.125%
Equity premium	6.0%
Equity beta	1.0
Gearing	60%
Forecast inflation	2.56%
Vanilla after tax real WACC	6.77%
Vanilla after tax nominal WACC	9.51%

Clause 4.1(j) specifies that the WACC input parameters to be used over 2014-15 must be calculated with:

- measurement of the market observables to occur in a period in 2013 proposed by the distributor and agreed by the AER (such agreement not to be unreasonably withheld), and
- market observables and non-market observables determined in accordance with the Statement of Regulatory Intent issued by the AER pursuant to clause 6.5.4 of the National Electricity Rules and as if clause 6.5.4(g) of the National Electricity Rules applied.

In accordance with the AMI Cost Recovery Order, JEN has proposed values for non-market observables that are the same as those in the AER's Statement of Regulatory Intent. Consistent with the AER's letter to JEN of 15 February 2011, in which the AER sets out its proposed process for setting the market observables for the WACC to apply to 2014 and 2015, JEN has proposed placeholder values for market observables—the risk free rate and the debt risk premium. The placeholder values are the same as those used for 2009 to 2013. By 30 November 2012, JEN will propose an averaging period to be used for market observables in 2014 and 2015.

JEN's proposed values for non-market observables, placeholder values proposed for the risk free rate and the debt risk premium, and the resulting WACC figures are shown in Table 3.2 below.

Table 3.2: Proposed WACC parameters and values for 2014-15, including placeholder values for market observables

Proposed WACC parameter	Value
Placeholder Risk free rate	4.63%
Placeholder Debt risk premium (inclusive of debt raising costs)	4.125%
Equity premium	6.50%
Equity beta	0.80
Gearing	60%
Forecast inflation	2.56%
Resulting vanilla after tax real	6.46%
Resulting vanilla after tax nominal	9.19%

4 Regulatory taxation

4.1 Regulatory tax losses

In determining the value for taxation to be included in the building block revenue requirement for the 2012 to 2015 charges, AMI Cost Recovery Order clause 4.1(e) requires the allowance to be set at zero in any one year that there is an estimated tax loss, and that the tax loss be carried forward for future years.

In accordance with clause 4.1(f) of the AMI Cost Recovery Order and section 3.5.4 of the AER Approach Paper, JEN has calculated its benchmark regulatory after tax loss as shown in Table 4.1.

Table 4.1: Benchmark regulatory after tax loss over subsequent budget period

Nominal \$m	2012	2013	2014	2015
After Tax Loss	(42.7)	(50.8)	(50.1)	(41.8)

JEN's benchmark after tax loss will result in no taxation liability for each year of the subsequent budget period. Therefore, in accordance with clause 4.1(e) of the AMI Cost Recovery Order, JEN has set the taxation liability at zero for each year of the subsequent budget period.

4.2 Value of imputation credits (gamma)

Consistent with JEN's position in the recent Victorian electricity distribution price review, JEN has proposed a value of gamma for 2014-2015 of 0.2.

5 Charges for Regulated Services

Clause 5A.1(c) of the AMI Cost Recovery Order requires charges to be set for 2012, 2013, 2014 and 2015 in this initial charges application. In its Approach Paper, the AER stipulated pricing principles to be used when setting the charges. This chapter sets out JEN's proposed charges for 2012 to 2015 and describes how those charges comply with the AER's pricing principles.

5.1 Proposed charges

Table 5.1 shows JEN's proposed charges for 2012 to 2015.

Table 5.1: Proposed Regulated Services charges for 2012 to 2015

Nominal \$/meter	2012	2013	2014	2015
Single phase single element	149.00	152.84	155.22	157.64
Single phase single element meter with contactor	149.00	152.84	155.22	157.64
Three phase direct connected meter	183.11	187.82	190.75	193.73
Three phase current transformer connected meter	203.58	208.82	212.08	215.39

5.2 Approach to setting charges

When determining charges, the AMI Cost Recovery Order states that:

- Charges be set to recover the net present value of building block costs incurred to date (clause 4.1(o)).
- At the distributor's discretion, charges may be set lower such that the net present value of total costs is not recovered in any one year (clause 4.1(p)).

In determining the charges for 2012-2015 JEN took the building block revenue requirements over 2012-2015 and:

- determined the level of charges that would apply if JEN set charges to recover the full net present value of building block costs in each calendar year (consistent with AMI Cost Recovery Order clause 4.1(o) and deemed to be compliant tariffs in the AER charges templates)

- considered an alternative path for the charges, such that would reduce customer impacts over 2012 to 2015, but would carry over the recovery of some costs beyond 2015, consistent with AMI Cost Recovery Order clauses 4.1(p), and 5L.

Consistent with AMI Cost Recovery Order clause 4.1(p), JEN has opted to set its proposed charges below the level that would be compliant with clause 4.1(o). The resulting price path of this approach is less volatile than a price path option that strictly complies with clause 4.1(o). JEN's proposed price path results in an initial 9 per cent increase in 2012, followed by an adjustment for inflation in 2013, and real price reductions in 2014 and 2015 (subject to the true up of actual revenues and costs). JEN notes that this approach will result in JEN under-recovering its revenue requirements over the subsequent budget period, with an expectation that JEN will recover the shortfall after 2015, in accordance with clause 5L of the AMI Cost Recovery Order.

JEN believes that the proposed price path for its AMI charges is simple and achieves an outcome that balances:

- customers' interests of minimal price volatility, with
- JEN's own interests in achieving cash flow certainty to match the significant required investment to meet the Regulated Services obligations.

In the event that the AER does not approve JEN's proposed reduced charges set out in Table 5.1 that are consistent with AMI Cost Recovery Order clause 4.1(p), JEN notes that charges consistent with AMI Cost Recovery Order clause 4.1(o) would apply.

5.3 Forecast quantities

In accordance with clause 4.1(l) of the AMI Cost Recovery Order, JEN has provided its latest quantity forecasts. Table 5.2 sets out JEN's forecast meter numbers over the subsequent budget period that have been used in calculating meter charges for 2012 and 2015.

Table 5.2: Forecast meter numbers over 2012 to 2015

Customer numbers	2012	2013	2014	2015
Single phase single element	245,379	249,272	252,611	255,924
Single phase single element meter with contactor	34,529	35,077	35,547	36,013
Three phase direct	31,917	32,423	32,857	33,288

Customer numbers	2012	2013	2014	2015
connected meter				
Three phase current transformer connected meter	2,712	2,755	2,791	2,828
Total	314,536	319,526	323,807	328,054

Given the true-up of actual costs and revenues that the AMI Cost Recovery Order provides for, any revenue impact of the discrepancy between forecast and actual meter numbers will be trued up each year.

5.4 Compliance with AER pricing principles

In section 4.5.2 of its Approach Paper, the AER set out the pricing principles that the Victorian distribution businesses need to comply with in proposing their charges. JEN's current charges—those applying in 2011—were approved by the AER as being consistent with its pricing principles.

JEN's proposed price path in this application ensures that, in any given year, the percentage change to any of JEN's four metering charges categories is the same. JEN therefore considers that its proposed charges will continue to be compliant with the AER pricing principles.



APPENDIX A: AER Templates

Attached as a separate file

APPENDIX B: 2009 Regulatory Accounting Statements

Attached as a separate file (confidential).